

FAIRNESS, EQUITY AND SAFETY NET WAGE ADJUSTMENTS

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Introduction

Wage rates reflect not only economic considerations, but also the underlying values, norms and structures of the societies in which they are set. Wage rates are not simply the product of economic factors, such as 'what the market will bear', but also perceptions of what is a fair and equitable distribution of rewards across workers, and between workers and their employers. The current debate over safety net wage adjustments (SNAs) in Australia raises some important issues relating to these non-economic or normative considerations.

SNAs were introduced to the Australian wages system in 1993 as part of the shift in wage determination towards enterprise bargaining (AIRC, 1993). They are currently available to all Award-covered workers who have been unable to access a wage increase via enterprise bargaining and who depend on adjustments to Award rates for their wage increases. Conservatively, about 25 percent of all Australian workers fall into this category (Peetz, 1998: 541)¹.

The fairness and equity issues that are raised in the debate on SNAs concern, first, the role played by these wage adjustments in protecting the welfare of workers at the bottom end of the earnings distribution. They also concern the role that SNAs play in protecting the relative wages of the other workers whom, for one reason or another, have not been able to secure a wage increase through enterprise bargaining.

To date, most of the academic commentary on SNAs has focused on the effects of regulating the wages of workers at the bottom of the earnings ladder, largely under the banner of minimum wage rates (see Dawkins, 1997; Richardson 1998; Neville, 1996 and 1997; Sloan, 1996; Valentine, 1996). Thus far, the effects of SNAs for the significant minority of workers who may not be 'low paid' but who still depend on adjustments to Award rates of pay for their wage increases have not been fully examined.

In this paper we attempt to focus more attention on the latter issue by discussing the possible effects of a plan by the Federal government to restrict the scope of SNA to the low paid (Reith, 1999). We begin by providing a very brief outline of the history and current role of safety net wages, highlighting the issues that have been raised in the first three Living Wage cases. In Section II we also briefly describe the proposals that have been made by the Federal government and by some prominent economists to pare back SNAs and to leave the determination of wage rates to 'market' forces. Section III

¹ This estimate of the number of workers dependent on SNAs includes only those workers who are formally entitled to such a wage adjustment (that is, those earning Award rates of pay). An additional, large group of workers receive over-Award payments and wage increases based informally on the SNA (Rimmer, 1998: 608-609).

examines the issues associated with these proposals, focusing, in particular, on the question of whether the determination of wage relativities can be safely left to market forces. Section IV provides a summary and conclusion.

Section II Safety Net Wage Adjustments

As was noted in the introduction, SNAs were introduced to the Australian wage system in 1993 as part of a general movement towards enterprise bargaining. Despite some changes to their scope², SNAs were retained by the Coalition government under the 1996 *Workplace Relations (and Other Legislation Amendment) Act 1996 (WRA Act 1996)* and have been the focus of three 'Living Wage' cases, the last of which was determined in April 1999.

The Australian Industrial Relations Commission (AIRC) is responsible for establishing and maintaining Safety Net Wages. In performing this function the AIRC is required by the Act to have regard to:

- a) the need to provide fair minimum standards for employees in the context of living standards generally prevailing in the Australian community;
- b) economic factors, including levels of productivity and inflation, and the desirability of attaining a high level of employment;
- c) when adjusting the safety net, the needs of the low paid.

(WRA Act 1996; Part VI, Section 88B(2))

Any SNA must also preserve the incentive for workers to engage in the process of enterprise bargaining (see AIRC, 1998).

The Living Wage Cases

The task involved in accommodating these various objectives for Safety Net Wages has been evident in each of the three Living Wage cases (1997-1999). Not surprisingly, the submissions of employers and governments to these cases have stressed the potential negative impact on economic activity and employment of a higher general level of wages. They have also expressed concern about the effects on wage relativities of SNAs, especially the possibility that interference with market determined relativities might generate structural unemployment (AIRC, 1998: 27-28).

In line with these concerns, employers and governments have argued either for no or only limited wage increases in each of the Living Wage cases. They have also argued that if

² Up until the mid 1990s SNAs were available to all workers who satisfied the test of having failed to receive a wage increase through enterprise bargaining. Since the passage of the *WRA Act 1996* the AIRC has restricted SNAs to workers whose whose actual wages (including over-Award payments) were close (e.g. within a band of around \$10) or equal to Award rates of pay (Peetz, 1998: 539).

any wage adjustment is awarded it should be limited to workers at the lower end of the earnings distribution, leaving the determination of wage relativities across occupational and industry groups to market forces. For example, The Joint Government³ submission to the most recent case proposed an \$8 per week SNA to be targeted to the low paid and linked to the Award simplification process. In other words, the \$8 would be available on application to minimum classification rates at or below the equivalent of the C10 (skilled tradesperson) rate in the Metal Industry Award- currently \$465.20 per week. Award rates above the C10 rate would not be varied as part of the SNA process.

In contrast, the submissions of the ACTU have emphasised the social function of wages (while at the same time refuting claims regarding the negative allocative effects of SNAs). According to the ACTU, the following principles should guide these wage adjustments: (a) the right of workers and families to a 'decent standard of living'; (b) a fairer and more equal distribution of economic and productivity growth, which reduces income inequality; (c) reference to achievements in the bargaining stream in the setting of Award rates; and (d) equal pay (ACTU, 1997: 2).

Accordingly, the ACTU has typically argued for SNAs that match the increase in wages and salaries recorded in other sectors of the economy (to preserve existing levels of earnings equality), and for these increases to be made available to all Award employees. It has also argued for wage increases that compensate for cost of living changes.

Some interesting submissions have also been made regarding the effects of SNAs on the incentives for workers and employers to engage in enterprise bargaining. Employers have emphasised that SNAs should be kept low to encourage workers to engage in bargaining with their employers. However, the ACTU has pointed out that, in the majority of cases, bargaining is an initiative of employers not employees and that employers will have a greater incentive to engage in bargaining (and to negotiate productivity improvements) if the SNA is large, not small (Peetz, 1998: 542).

The AIRC's response to these submissions has given credence to the various arguments put to it. In the most recent decision (April 1999), Award rates of up to and including \$510 per week were increased by \$12 per week, whilst those above \$510 were increased by \$10. (The ACTU claim was for increases of \$26.60 per week for all Award rates of pay up to \$527.80 per week; and a 5 percent increase in Award rates of pay above that level (AIRC, 1999)).

On the economic effects of this decision the AIRC argued that, due to the small contribution to aggregate wage outcomes of the SNAs, they would have only a limited effect on economic activity. However, the Commission did grant a lower dollar amount in this case than it did in the 1998 Living Wage case due to a concern about a predicted easing in economic growth and a 'desire not to jeopardise the emerging downward trend

³ The Joint Government Submission was comprised of the Commonwealth Government and the governments of South Australia, Victoria, Western Australia, the ACT and the NT.

in unemployment' (AIRC, 1999). The Commission also amended the Economic Incapacity Principle to take into account the possibility that some employers may not have the financial capacity to fund the wage increase.

On the social outcomes, the AIRC expressed its concern about the rising level of earnings inequality in Australia, especially the growing 'gap between the income levels established as a result of bargaining and those determined by the Award system' (AIRC, 1999). Its decision in the 1999 Living Wage case to award an increase of \$12 per week for workers earning less than \$510 per week reflects this concern, with it being explicitly designed to be in line with the increase in earnings generally (*ibid.*).

However, the Commission recognised that the \$10 per week wage increase for workers earning more than \$510 per week would not fully address the gap between the earnings of these SNA workers and those in the bargaining stream (although it would maintain the real value of their wages). This represented a compromise of the Commission's equity objectives for cost considerations (*ibid.*).

Despite this, the fact that the Commission awarded a wage increase to workers earning more than \$510 per week at all represents an important interpretation of the social issues involved in the SNAs. As was noted above, employers and several governments submitted that the SNA should only apply to workers classified at or below the C10 rate. This would leave the structure of internal relativities (within each Award) subject only to market pressures. Workers employed above the C10 rate who were unable to secure a wage increase through bargaining would see their wage position erode relative both to workers below the C10 rate and to those workers who were able to secure increases in the market. The Commission rejected this submission and in doing so it asserted that fairness entailed not only protecting the wages of those workers at the bottom of the earnings ladder but also protecting the relative wage position of other workers.

The AIRC's comments on its decision in the 1997 Living Wage case (AIRC, 1997) make clear its interpretation of the importance of wage relativities. There it asserted that:

Such relativities remain an important determinant of the fairness of the minimum wage structure within Awards. How can Award rates be fair if they do not properly reflect the relative skills, responsibilities, etc of jobs covered by the Award? If an Award system has to be fair, then it is no answer, as the Joint Governments suggest, to leave it to workplace agreements to establish appropriate relativities.

Proposals for Change

Since the last Living Wage Case the Federal Minister for Employment, Workplace Relations and Small Business, The Hon. Peter Reith, has tabled his 'second wave' of industrial relations reforms as foreshadowed in Reith (1999). The *Workplace Relations Legislation Amendment (More Jobs, Better Pay) Bill 1999 (WRLA Bill 1999)*, which is currently before the Commonwealth Parliament, has a similar flavour to the Government submission to the last (1998) Living Wage case. Paragraphs 88A(b and ba) of the Bill would repeal paragraph 88A(b) of the Act ("Awards act as a safety net of fair minimum wages and conditions of employment) and substitute:

- (b) Awards act as a safety net providing basic minimum wages and conditions of employment in respect of appropriate allowable Award matters to help address the needs of the *low paid*; and
- (ba) Awards do not provide for wages and conditions of employment above the safety net

(WRLA Bill 1999; Paragraph 88A, emphasis added)

The Bill also would insert a new clause into the Act, Paragraph 88c 'Commission not to have regard to relativities within Awards'

Consistent with ensuring that Awards act as a safety net providing basic minimum conditions of employment in respect of appropriate allowable Award matters to help protect the low paid, in performing its functions under this Part the Commission *must not* have regard to the maintenance of relativities between classification rates of pay within individual Awards.

(WRLA Bill 1999; Paragraph 88C, emphasis added)

Some prominent academic economists have also made recommendations on how future SNAs should be conducted (Dawkins, Freebairn, Garnaut, Keating and Richardson, 1998). Their emphasis is very much on the allocative side, arguing that SNAs be frozen for four years and the low paid be compensated through the tax/social welfare system. The principal objective of their plan is to reduce real wage growth and, thus, unemployment. They note that "[e]arnings would be suppressed more for low-skilled than for high-skilled workers". However, this would have a positive effect on employment as "the unemployed are disproportionately low skilled" (*ibid.*).

Both these proposals would further reduce the importance attached, at the regulatory level at least, to the social function of wages. The "Dawkins Proposal" would shift responsibility for the protection of the welfare of low paid workers away from the wage determination system to the tax and social welfare system. Both the Reith and Dawkins proposals would reduce the AIRC's role in protecting the relative wages of workers. Under both proposals the structure of wage relativities would be largely left to market forces.

Section III Safety Net Adjustments and Wage Relativities

Many questions are raised by these proposals for SNAs. For example, is the social function of wages unimportant? Can the role that has been played by minimum wage rates in protecting the incomes of the low paid be replaced by the taxation/welfare system? Can the determination of wage rates of workers other than the low-paid be safely left to market forces? What would be the likely effects on equity of such a change? Are the gains in allocative efficiency that may come from these proposed changes sufficient to justify the loss of fairness in the wage system?

The pros and cons of using minimum wage controls to protect the welfare of low paid workers has been discussed extensively elsewhere (see Dawkins, 1997; Richardson 1998; Hancock, 1998; Neville, 1996 and 1997; Sloan, 1996; Valentine, 1996). However, the issue of leaving the determination of other wage rates to market forces has received less attention. This is somewhat surprising, given the large number of workers who would be affected by restricting SNAs to the C10 rate, and given that it is less than certain that workers who do earn above the C10 rate would be compensated through the welfare or tax system for any reduction in their real wages.

The argument for the deregulation of wage rates (see Dawkins, 1998 for an overview) derive from competitive wage theory which, in very simple terms, suggests that wage differentials should reflect: (a) the value of different skills in the productive process and how these values vary across workplaces according to the demand for final goods and services; and (b) the cost to workers of acquiring different skills and supplying labour in different workplaces.

This theory suggests that if wage differentials do adjust to reflect changes in, for example, the market value of a particular firm's product, and if labour 'moves' in response to this price signal, then two desirable outcomes will result. First, workers will be paid a wage rate that reflects the market value of their contribution to the productive process. Second, labour will be utilised in the sectors and firms where it is most valued (i.e., allocative efficiency will be achieved). Lower levels of structural unemployment and higher levels of economic performance should flow from this.

The argument against further deregulation of wage rates starts by pointing out the limited relevance of these theoretical models to modern labour markets. Neither the labour market nor most product markets are characterised by perfect competition and, given this, there is no guarantee that deregulation will result in a pattern of wage relativities that correctly signal the efficient allocation of labour, or reward workers according to their contribution to output. For example, textbook economics tells us that a firm with monopoly power in its product market could be expected to pay higher wages than a firm exposed to competitive pressure, regardless of the social value of the two firm's products. Furthermore, employers with some degree of monopsony power may take advantage of their superior bargaining strength to push wages down below the value of the worker's contribution (see Rubery, 1997: 356-357; Peetz, 1998: 538).

Further arguments against the deregulation of wage determination flow from this critique. First, there is a concern that the deregulation of wages will result in further increases in earnings inequality, both across the workforce as a whole and between male and female workers. The groups who are most threatened by the processes of 'competition' in a deregulated labour market are those with the poorest bargaining power and these workers typically already earn below average wages (Peetz, 1998: 549). Furthermore, the industries with the poorest record in terms of bargaining wage increases through enterprise agreements (that is, the health and community services, education, retail and hospitality industries (see Rimmer, 1998: 609)) are those with the highest concentration of female workers (see CoA, 1998: 47).

The record of other countries' experience with labour market deregulation also suggests that there is a real risk of exacerbating earnings inequality. For example, Fortin and Lemieux (1997) demonstrate a clear relationship between the decline in the real value of the minimum wage in the United States and both rising general levels of wage inequality and an increase in the gender earnings gap. Cross-country studies also point to a significant inverse relationship between the degree of centralisation of wage-setting and wage dispersion (Borland and Woodbridge, 1998: 20). Supporting this, empirical studies of the Australian system of wage determination suggest that regulation has resulted in a more egalitarian wage structure by improving outcomes for low-wage workers in particular (Norris, 1986: 199).

A further social concern with the deregulation of wage relativities is whether important norms of wage justice will be reflected in a wage structure determined by market forces. Social norms of equity assert that a person's wages should be based on his or her contribution to output and, thus, that workers should be rewarded for their skill, education, training and effort and be paid according to the difficulty, complexity and supervisory responsibility of their job (see Kelley and Evans, 1993: 117). In line with this, the fairness of pay differentials (relativities) between occupations and workers is commonly assessed with reference to the physical characteristics of different jobs. Changes in wage relativities according to the vagaries of the market or worker's bargaining power are typically considered unfair (see Kahneman, Knetsch and Thaler, 1986).

Alfred Marshall (1887: 212-213) emphasised the importance of these community standards of wage justice more than a hundred years ago when he asserted that:

...every man who is up to the usual standard of efficiency of his trade in his own neighbourhood, and exerts himself honestly, ought to be paid for his work at the usual rate for his trade and neighbourhood; so that he may be able to live in that way to which he and his neighbours in his rank of life have been accustomed. And further, the popular notions of fairness demand that he should be paid this rate ungrudgingly; that his time should not be taken up in fighting for it; and that he should not be worried by constant attempts to screw his pay down by indirect means.

These standards of wage justice have also been identified in a range of modern studies of wage setting. For example, Barbara Wootton (1962: 162) described how the maintenance of wage differentials is “woven as warp and woof into the texture of wage discussions”. She described how workers and unions couch many of their arguments for wage increases either in terms of changes in the content of their jobs or the ‘fairness’ of maintaining a particular wage level in relation to a comparable group of workers. Employers also rely heavily on wage comparisons in their approach to wage negotiations and appear to place emphasis on paying wages that at least equal those of comparable employers in their local area (see also Ross, 1948; Piore, 1973; Hyman and Brough, 1975; Rees, 1993; Brown and Sisson, 1975; Dickinson, 1998; Rimmer, 1998: 615). The stability of many occupational wage relativities over long periods of time has also been related to the application of this standard of justice (see Routh, 1965; Phelps Brown, 1975).

However, as Adam Smith foresaw, wage justice is not a certain outcome for all workers in a modern labour market. He noted that the payment of ‘just wages’ depended on there being virtuous, well-informed traders, prepared to limit the pursuit of their own interests when these interests conflict with the interests of society at large (Stabile, 1997: 298). He perceived that this might occur ‘naturally’ in small, well-established communities, where close social ties elicit emotional responses such as sympathy and, thus, encourage the exercise of ‘self-command’ by employers. However, in large urban centres the depersonalisation of social relations could lead to the dissipation of feelings of sympathy for other community members and, hence, “[w]ages below the natural rate might exist, and employers, workers and the community not know or care about it” (Stabile, 1997: 305).

To compensate for the risk of unjust wages, and to ensure that society’s interests were not harmed by the operations of markets, Smith formulated a role for a well-informed, *impartial spectator*. This spectator would be a moral guardian who would evaluate whether each individual’s actions were virtuous or not, and who would guide behaviour to ensure that society’s best interests were served (ibid).

Thus, although Smith did have a pessimistic view of wage regulation (for example, in “The Wealth of Nations” Smith (1976I: 158-159) wrote: “Whenever the legislature attempts to regulate the differences between masters and their workmen, its counsellors are always the masters” and regulations are always aimed at lowering them)⁴, he clearly perceived risks in leaving the determination of wages entirely to market forces. In a decentralised market economy subject to the pressures of competition, employers may be tempted to pay wages that do not reflect agreed social values or support the long-term interests of their communities⁵ (see also Rubery, 1997: 358-359).

⁴ Nevertheless, Smith went on to say “When the regulation... is in favour of the workmen it is always just and equitable”(ibid).

⁵ A similar idea is reflected in the game theoretic literature on social norms, where it is shown that unfettered competition leads market participants to select actions that are not socially optimal (see Binmore, 1998)

Finally, there are also concerns about the economic effects of further deregulation of wage rates. In particular, the above discussion on the importance of norms of equity suggests that employers may be unwillingness or unable to vary wage rates according to market conditions (and, thus, to provide the signals to the efficient allocation of labour). For example, if workers do hold to the norms of equity described above, then they may resist attempts to vary their wages according to market conditions. Either the predicted wage changes will not eventuate or productivity may go down rather than up in a deregulated system (see Isaac,1992: 3; Piore, 1973:378).

IV Summary and Conclusion

The current proposals to pare back Safety Net Wage Adjustments will limit the ability of the AIRC to reflect the social elements of wages in their decisions. These changes to the SNAs will affect the welfare of a large number of Australian workers. Restriction of the SNAs will leave the relative wage position of many workers subject to the influence of market forces and, most likely, a deterioration in earnings inequality and the gender wage gap will result. Given the weak bargaining position of the workers who currently depend on SNAs, there is a strong risk that comparative wage justice will be sacrificed for the promise of gains in allocative efficiency.

The argument that further labour market deregulation would lead to lower levels of unemployment and higher levels of economic growth demands that these proposals for change in the SNA system be given serious consideration. However, detailed information is needed on the nature and size of the predicted effects on employment and productivity to ensure that they are large and certain enough to justify the social costs that would be involved.

There is clearly a need for more research on the issues raised in this paper. In particular, more detailed information on the consequences of the proposed changes in SNAs for earnings inequality, and especially for the relative position of low-wage workers, is needed so that the social costs of these changes can be gauged. The benefits of further deregulation of wage fixation in terms of employment growth and economic performance also need to be better defined before these changes are implemented.

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